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APPLICATION OF

SOUTHWESTERN VIRGINIA GAS COMPANY

CASE NO. PUE-2002-00517

**For an expedited increase
in rates**

REPORT OF DEBORAH V. ELLENBERG, CHIEF HEARING EXAMINER

February 26, 2003

On September 23, 2002, Southwestern Virginia Gas Company ("Southwestern" or the "Company") filed a rate application, supporting testimony and exhibits with the Commission for an expedited increase in rates. The Company sought to increase its annual revenues by \$433,435, an increase of approximately 5%. The Company also proposed to increase its reconnection fee from \$30 to \$50, and requested that the increase in rates and the reconnection fee be allowed to go into effect for bills rendered on and after October 31, 2002.

The Company requested a waiver from reporting certain information for its parent, Southwestern Virginia Energy Industries, Ltd. ("Parent"), and the consolidated information of the Parent and the Company as required in the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30, *et seq.*, on Schedules 1, 2, 6, and 7. The Company contends that: (1) the Parent has historically never contributed to the raising of capital for the Company; (2) the Parent has historically never assisted the Company in raising capital either by guaranteeing debt or in any other manner securing the Company's obligations; (3) the Parent is a closely held corporation and not traded publicly; and (4) the Parent does not have financial statements prepared for public distribution.

The Company further requested a waiver of the requirement to prepare a jurisdictional cost of service study. In support of that request Southwestern stated that it serves very few governmental non-jurisdictional customers; in fact, the Company states that the only non-jurisdictional customers -- governmental offices and schools -- represent less than 1.1% of the Company's customers and 2.8% of its gas throughput. According to Southwestern, these non-jurisdictional customers pay for service on the basis of Commission-approved rates; thus, there is virtually no impact on the per customer cost of service and no economic justification to expend the money, time and effort to create a non-jurisdictional cost study.

By order dated October 11, 2002, as amended on October 18, 2002, the Commission authorized the Company to place its proposed rates into effect on an interim basis subject to refund. The Commission also established a procedural schedule for the case, and set a hearing date for February 11, 2003, to receive evidence on the Company's application.

The hearing was convened as scheduled. Richard D. Gary, Esquire, appeared as counsel for the Company. Allison L. Held, Esquire, and Katharine A. Hart, Esquire, appeared as counsel for the Staff. No public witnesses appeared to offer comments on the application.

The Company and Staff offered a Stipulation at the hearing in which they proposed to offer the prefiled testimony into the record without causing the witnesses to come forward and be subject to cross-examination. The Stipulation sets forth the Company's and Staff's agreement that the record supports a fair and reasonable annual increase in revenues of \$339,052 based on the capital structure and cost of capital reflected in the Staff's testimony and exhibits. The increase is based on a return on equity of 10.3%, and a range of 9.80% to 10.80%. The Stipulation is attached hereto as Attachment A.

In the Stipulation and at the conclusion of the hearing, counsel for the Company requested that Southwestern be allowed to place the lower rates into effect. The Company contends that the revenue requirement that Staff recommended and to which it agreed in the Stipulation is lower than the revenue requirement that rates now in effect on an interim basis are designed to recover. Southwestern sought to reduce interim rates effective as of February 1, 2003, for bills rendered on and after February 28, 2003, to replace the higher rates being charged since October 1, 2002. Such action would decrease the Company's ultimate refund liability. Staff concurred. The Company's request was found to be reasonable.¹ The transcript of the hearing is filed with this Report.

The Company offered the prefiled testimony of Lance G. Heater,² executive vice president-chief operating officer, and Bernadette J. Stowe,³ assistant treasurer, in support of its application.

Mr. Heater provided general Company information, identified the impact of the loss of two major customers during the test year, and addressed a proposed increase in the reconnection fee. Ms. Stowe offered testimony to support the Company's calculation of its revenue requirement in this case.

The Staff prefiled the testimony of John B. Barker, a senior public utility accountant with the Commission's Division of Public Utility Accounting; John R. Ballsrud, a principal financial analyst in the Division of Economics and Finance; and David A. Roberts, a utilities analyst in the Division of Energy Regulation.

Mr. Barker conducted an accounting audit of the Company's financial books and recommended several adjustments. Staff witness Barker concluded that the Company has operating income of \$215,300, after Staff adjustments. That produced a return on rate base of 4.12%. Staff therefore recommended a revenue increase of \$339,052 based on a return on equity of 10.30%. That rate increase will provide for adjusted operating income of \$425,252, and a return on rate base of 8.127%.⁴

¹Transcript 9. The Company filed revised tariff sheets on February 12, 2003. The Company's request to place lower rates into effect for bills rendered on and after February 28, 2003, should be, and hereby is, granted.

²Exhibit 1.

³Exhibit 2.

⁴Exhibit 4, at 17.

Mr. Barker also offered testimony that the Company's non-jurisdictional customers represent only 1.1% of its total customers and consume only 2.8% of total gas throughput. Non-jurisdictional customers pay the same rates as jurisdictional customers. The Company prepared all schedules and adjustments as if it had no jurisdictional customers. Staff verified that such an approach is consistent with the Company's last case and it had no objection to the continued use of that approach in this case.⁵ Mr. Barker further testified that the Company has not performed a depreciation study since 1995. He recommended that the Company be required to file a depreciation study in a timely manner within one year of the Final Order in this case and every five years thereafter.⁶

Mr. Ballsrud recommends using an actual June 30, 2002, capital structure consistent with the Company's proposal, with one minor adjustment to the Company's cost of long-term debt. He estimated the cost of equity for an average gas distribution company using the Discounted Cash Flow analysis and several risk premium methodologies using market data through December of 2002. Based on his analyses he concluded that the Company's return on equity should be in the range of 9.80% to 10.80%, with the midpoint of 10.30% used to set rates. That cost of equity did not include an upward risk adjustment of twenty basis points reflected in the Company's previously authorized range, because in Mr. Ballsrud's opinion such an adjustment was no longer warranted.⁷

Mr. Roberts discussed the Company's proposals to increase its "non-gas" base rates and service reconnection fees. He also supported Mr. Barker's conclusion that the size and impact of the Company's non-jurisdictional customers did not justify the effort necessary to separate non-jurisdictional customers from other customer classes. He concurred with the Company's request for a waiver from the requirement to conduct such a study. Staff prepared a class cost of service study using a 50/50 demand-commodity allocation of distribution mains and related investments. Staff opined that although it generally prefers to see all customer classes moving toward parity, the transportation class has only one customer, and accordingly, that single customer would bear the entire cost of any revenue requirement allocated to that class. Thus even a slight movement toward parity would be insufficient to justify the additional cost that customer would incur. Staff therefore does not propose an alternative revenue allocation for the sole purpose of moving the transportation rates toward parity.⁸ Mr. Roberts also addressed the Company's proposal to increase its service reconnection fee. He verified that the Company submitted cost data showing the average cost for shutting off and reconnecting customers was \$61.18.⁹ Staff therefore supports the Company's request to increase that service fee to \$50. Finally, Mr. Roberts recommended that if the Commission approves a smaller increase in revenue than was requested by the Company, it should be allocated to customer classes in accordance with the same percentages proposed by the Company.¹⁰

⁵Id. at 3.

⁶Id. at 17.

⁷Exhibit 5, at 2.

⁸Exhibit 6, at 3-4.

⁹Id. at 5.

¹⁰Id.

The Company prefiled the rebuttal testimony of Ms. Stowe;¹¹ however, at the hearing the Company advised that it no longer intended to seek the two adjustments requested in the rebuttal testimony. It urged the Commission to adopt the findings in the Stipulation.

DISCUSSION

The Company last filed an application for rate relief on September 24, 1997, seeking additional operating revenues of \$251,427 based on a test year ending June 30, 1997. The Commission granted an increase in additional revenues of \$99,696 based on a return on equity of 10.60%.¹²

The current application seeks additional annual revenues of \$433,435 for bills rendered on and after October 31, 2002. The request for rate relief is based largely on the loss of two large industrial transportation customers, Bassett Walker Knitting and E.I. Dupont, during the test year. In the last full fiscal year of operation those two customers were responsible for usage totaling 285,805 Mcf, approximately 15% of the Company's total throughput, and gross annual revenues of approximately \$137,000.¹³

After considering the Company's and Staff's testimony, exhibits, and the Stipulation admitted into the record, I find that an annual increase in revenues of \$339,052 is reasonable and should be approved by the Commission. I also find that the Company's proposed increase in the reconnection fee is justified by the costs of such service, and should also be approved by the Commission.

FINDINGS AND RECOMMENDATIONS

In conclusion, based on the Stipulation and the evidence received in this case, I find that:

1. The use of a test year ending June 30, 2002, is proper in this proceeding;
2. Southwestern's test year operating revenues, after all adjustments, were \$8,633,532;
3. Southwestern's test year operating deductions, after all adjustments, were \$8,411,737;
4. Southwestern's current rates produce a return on adjusted rate base of 4.115%;
5. A reasonable return on equity for Southwestern is in the range of 9.80% to 10.80%, and the midpoint of 10.30% should be used to calculate rates;
6. Southwestern's adjusted test year rate base is \$5,232,579;

¹¹Exhibit 3.

¹²*Application of Southwestern Virginia Gas Company*, Case No. PUE-1997-00765, 1998 S.C.C. Ann. Rep. 382.

¹³Exhibit 4, at 2.

7. Southwestern requires \$339,052 in gross annual revenues to earn a return on rate base of 8.127%, and a return on common equity of 10.30%;

8. Southwestern's proposed increase in its reconnection fee from \$30 to \$50 is reasonable;

9. The Company should be directed to prepare a depreciation study within one year of the Final Order in this case and every five years thereafter; and

10. The Company should be granted a waiver of the rules requiring the report of information for its Parent, the consolidated information of the Company and its Parent, and a jurisdictional cost of service study.

In accordance with the above findings, ***I RECOMMEND*** the Commission enter an order that:

1. ***ADOPTS*** the Stipulation and the findings in this report;

2. ***GRANTS*** the waivers requested by the Company;

3. ***GRANTS*** an increase in annual gross revenues of \$339,052 as recommended in the Stipulation;

4. ***GRANTS*** an increase in the reconnection fee to \$50;

5. ***DIRECTS*** the Company to refund with interest any excess revenues that have been collected;

6. ***DIRECTS*** the Company to perform a depreciation study within one year of a Final Order herein and every five years thereafter; and

7. ***DISMISSES*** this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and 5 VAC 5-20-120 C) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within seven (7) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such

document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

Deborah V. Ellenberg
Chief Hearing Examiner